

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA**

**CORAM: DR. K. M. ABRAHAM, WHOLE TIME MEMBER**

**ORDER IN COMPLIANCE WITH THE DIRECTIONS OF THE HON'BLE HIGH COURT OF JUDICATURE AT BOMBAY ISSUED IN THE MATTER OF RAJKOT SAHER/JILLA GRAHAK SURAKSHA MANDAL & ANOTHER VS. UNION OF INDIA & ANOTHER (P.I.L. NO. 50 OF 2009), VIDE ORDER DATED JUNE 18, 2009**

**Date of Hearing: July 14, 2009**

**Appearance:**

For Rajkot Saher/Jilla Grahak Suraksha Mandal: Mr. Mohammad Shaffiq, Advocate  
Mr. Murari Madekar, M/s Madekar & Co  
Mr. Ramjibhai B. Mavani, Founder President  
Mrs. Ramaben Mavani, President

For Securities and Exchange Board of India: Mr. Sanjay Puroo, Deputy General Manager  
Mr. Vijaykrishnan G, Deputy Legal Adviser  
Mr. Suraj Mohan M, Assistant General Manager  
Mr. T. Vinay Rajneesh, Legal Officer  
Ms. Chhavi Sinha, Legal Officer

1. The Hon'ble High Court of Judicature at Bombay, vide order dated June 18, 2009 in P.I.L. No. 50 of 2009 (Rajkot Saher/Jilla Grahak Suraksha Mandal and another Vs. Union of India and another) directed Securities and Exchange Board of India (hereinafter referred to as SEBI) to hear the petitioner (Rajkot Saher/Jilla Grahak Suraksha Mandal) in respect of its representation dated June 04, 2009 made to SEBI and pass appropriate orders in accordance with law ,within six weeks from the date of the order. Accordingly, in terms of the said order of the Hon'ble High Court, SEBI granted an opportunity of hearing to

Rajkot Saher/Jilla Grahak Suraksha Mandal (hereinafter referred to as the petitioner) on July 14, 2009. On the said date, Mr. Mohammad Shaffiq, advocate represented the petitioner and made submissions. Mr. Murari Madekar (M/s Madekar & Co), Mr. Ramjibhai B. Mavani, and Mrs. Ramaben Mavani (office bearers of the petitioner) were also present during the hearing.

2. The petitioner had *inter alia* submitted the following, in its representation dated June 04, 2009:

- a. That the objective of their representation was to expose a massive and orchestrated scam by the promoters and people enjoying controlling interest in a large number of Companies, in exercising the powers under Section 81 (1A) of the Companies Act, 1956 (hereinafter referred to as the Act) read with the Securities and Exchange Board of India (Disclosure & Investor Protection) Guidelines 2000 (hereinafter referred to as the Guidelines), arbitrarily for their personal aggrandizement at the cost of the company and its investors, whose interest they are duty bound to protect;
- b. That their representation is towards ensuring that any further issue of Share Capital is for the benefit of the Company and all its shareholders including public financial institutions and general public, and that the interest of the investors, which is the primary objective of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as SEBI Act) is protected;
- c. That the uniformity in the actions of the promoters indulging in exercising the powers under Section 81 (1A) of Act and the blatant and flagrant misuse of the guidelines under Chapter XIII of the Guidelines, was a very disturbing aspect demonstrating the inadequacies in the Guidelines for Preferential Issues contained in Chapter XIII of the Guidelines, which was being misused by the promoters controlling the companies, by exercising the discretion to issue further share capital solely for their personal ends, to the exclusion of the shareholders by taking undue advantage of the absence of sufficient safeguards/deterrents, and a subsequent failure to exercise the option, depending on the movement in the price of the shares, followed by fresh allotment of preferential shares to the very same promoters immediately (at very low prices as compared to earlier conversion prices which the promoters

failed to subscribe), causing grave prejudice to the company and the investors;

- d. That the guidelines for preferential shares had been issued by SEBI in exercise of its powers under Section 11 of the SEBI Act and that the issue of further capital (preferential shares) is made by a company in terms of Section 81 of the Act. That Section 55A of the Act empowers SEBI to administer various provisions of the Act including Section 81 in so far as they relate to issue and transfer of securities. That the Guidelines made in exercise of the powers under Section 11 of the SEBI Act read with Section 81 and 55 A of the Act ought to be exercised in a manner which attains the following objectives:
- *Protect the interest of investors.*
  - *Further issue of share capital must be for the benefit of the company as a whole.*
  - *Further issue of share capital ought not be used a tool for the personal aggrandizement of the people vested with the discretion to decide the further issuance of share capital.*
  - *To ensure that there are sufficient safeguards/deterrents against the misuse of the above power/provision.*
- e. That the companies which had cancelled the promoters warrants/forfeited the upfront money paid by the promoters/again reissued the warrants at a low price include Aditya Birla Nuvo Limited, Tata Power Ltd., Reliance Infrastructure Limited, Pantaloon Retail Limited, Hindalco, Great Eastern Shipping Company Ltd , Amtek Auto Ltd Nagarjuna Fertilizers Ltd etc.;
- f. That the board of directors of those companies, including the independent directors have misled SEBI, Stock Exchange and shareholders, regarding the requirement of funds for the company at the time of initial preferential allotment of warrants to the Promoters. This was because, the boards have either cancelled the warrants/allowed the warrants to lapse and, in some cases have not bothered to raise fresh capital at all and in some other cases, have again reissued the same quantum of warrants to the promoters at much lower prices due to which the company would be raising much lower amounts as equity. That the board was prepared to wait for another 18 months for raising the funds, is completely illusory. That the only reason for any of these preferential offers to the promoters is only for increasing the promoters holding in those companies;

- g. That the directors of the companies have not discharged their fiduciary obligations to the shareholders and the company and that they had acted only for the interest of the promoters;
- h. That the independent directors and nominee directors, if any, ought to have raised objections and stopped the re-issue of warrants to the promoters who have defaulted earlier. That on the dates of the board meeting of the companies under illustration, the independent Directors were very well aware of the direction the stock market would take and that they should have insisted that any fresh fund raising by way of equity should only be done by way of Rights Issue which would benefit all the shareholders of the company;
- i. That the promoters of those companies have only their personal interest in mind which was to the detriment to the company and other shareholders;
- j. That the promoters had used the provisions of the Guidelines to do '*Option Trading*' with the company itself rather than in the Stock Exchanges and that the only difference was that an investor who would have done an Option Trading would have lost the Option price in the above circumstances, but the promoters by indulging in re-issue of shares at a very low price have converted their losses into huge gains at the cost of other shareholders;
- k. That with respect to any further issue of share capital under Section 81 of the Act, the board should exercise its power for promoting the interest of the company as a whole, and it ought not use the same to advance the personal ends of the promoters of the company;
- l. That the SEBI is vested with powers to administer Section 81 of the Act and is cast with a duty to frame adequate guidelines keeping in view the above objective, but has failed miserably in ensuring that the objective is not defeated through some deceptive device, design or unfair practice;
- m. That the Guidelines which are to protect the interest of the investors and to ensure that the further issue of share capital is to the benefit of the Company as a whole, in the absence of adequate safe guards and deterrents, has failed to attain the objective, to the contrary the Guidelines are used as a tool by the promoters for advancing their personal interest.

- n. That the forfeiture clause providing for forfeiture of the payment of 10% (now 25%) is not an adequate deterrent, which is clear from the fact that even after the forfeiture, the shares are being allotted afresh with the approval of the board of directors enabling the promoters to attain their objective of increasing their stakes in the company originally aimed at, but at a fraction of the original price which is completely to the detriment of the company and its investors and only promotes the promoters;
- o. That they could not understand as to why warrant issue with an option to subscribe or not has been prescribed in the Guidelines. That the Guidelines itself is for an exception to the General Law (Section 81(1A) of the Act) is being misused by those unscrupulous promoters.
- p. That if SEBI conducts a detailed study of the preferential issues under the Guidelines, it would find that more than 80% of the preferential allotments by listed companies have only been to the promoters and that the warrant route has been enjoyed only by the promoters and it is hard to find any instance where the facility of payment over a period of 18 months have been given to any allottee other than a promoter in a preferential offer;

3. The petitioner had also annexed (Annexure 1 to its representation), the chronological sequence of events in respect of the aforesaid companies (mentioned in Para 2(e) above), as an illustration. Further, the financial impact of the fraud perpetrated by those promoters on other shareholders and the company was annexed as Annexure 2 to their representation. In view of its submissions, the petitioner in its representation had requested SEBI to take the following steps (reproduced from their representation):

*"1. Investigate the manner in which decisions have been taken by the Board of directors for allotment of warrants to the same Promoters who have defaulted in their commitment earlier and the role of the independent/nominee directors who have failed miserably in their fiduciary duty to the Company, resulting and causing grave prejudice to the interest of investors whose interest this Hon'ble Authority is bound to protect.*

*2. Amend the Preferential Issue guidelines to the effect that any preferential issue, including to Promoters can only be of shares or convertible instruments on payment of full amount payable towards the issue. The Promoters cannot be permitted to cheat the company by making a commitment of paying within 18 months and at the end of 18 months suddenly deciding unilaterally not to pay the committed funds for the growth of the company.*

*3. Strictly prohibit further preferential issue to such persons who have defaulted in their commitments to the company for taking allotment of shares against warrants allotted to them earlier.*

*4. Should immediately issue regulations prohibiting the Promoters from voting in the General Meeting on any resolution in which they are interested like this one.”*

4. During the personal hearing, the learned counsel submitted that the promoters of various companies were allotting themselves warrants by paying only 10% of the price as upfront amount as per the Guidelines and by the time the warrants were due to be exercised and converted into equity shares, the promoters did not exercise the same as the market price of the shares had fallen much below the exercise price which allowed the warrants to lapse or for the companies to cancel the warrants. It was further submitted that, when the market expected to recover due to the results of the general elections, the promoters who earlier did not exercise the warrants made the companies to issue warrants afresh to them. The learned counsel also referred to 8 instances where in 8 listed companies,(names of the said companies mentioned in paragraph 2 above), the promoters allegedly did not exercise the option to convert warrants into equity shares when market price of the shares of the company fell below the warrant exercise price calculated according to the Guidelines. It was also pointed out by the learned counsel that the board of some companies, prior to the due date (of conversion of warrants), had cancelled the warrants so issued to the promoters, so that the promoters are cleared from the stigma of being called a ‘defaulter’, thus enabling the company to allot further warrants to the promoters at a very low price so as to enable

them to make unjustified profits and gains of astronomical amounts to the detriment of the company and general body of shareholders. The learned counsel also argued that the independent directors and nominee directors, ought to have raised objections and stopped the re-issue of warrants to the promoters who have defaulted in exercising their option, earlier. The learned counsel filed a compilation of case laws in support of his submissions that the objective of SEBI is to protect the interest of investors and to ensure that there are sufficient safeguards/deterrents against the misuse of the relevant provisions.

5. Considering the representation dated June 04, 2009 of the petitioner and the oral submissions made on its behalf by the learned counsel, my findings are as under:

6. It is noted that the Guidelines on preferential allotment have been in existence since 1994 and were framed out of SEBI's concern that promoters may allot themselves shares and warrants at favourable prices under the garb of 'preferential allotment', and profit from the same, to the disadvantage of the other shareholders. It is pertinent to note that Section 81(1A) of the Act enables allotment of shares to any person(s) other than by way of rights issues and a company which desires to make a preferential allotment of its shares to a select group of persons, whether promoter or non promoter, has to get a special resolution passed in the general body meeting of its shareholders. In addition to the provisions of Section 81(1A) of the Act, Chapter XIII of the Guidelines seeks to provide further checks and balances to protect the interest of investors. Chapter XIII of the Guidelines prescribes the guidelines for preferential issue of equity shares/fully convertible debentures/partly convertible debentures or any other financial instruments which would be converted into or exchanged with

equity shares at a later date, by listed companies, to any select group of persons under Section 81(1A) of the Act on private placement basis. While no permission from SEBI is required for making preferential issues by listed companies, compliance with the following additional requirements laid down in the Guidelines is required to be ensured by the company while making a preferential issue:

#### **A. DISCLOSURES**

- i. The explanatory statement to the notice to shareholder's meeting where the proposal for preferential allotment is put for shareholders approval should contain disclosures regarding objects of proposed preferential allotment, intention of the promoters/directors /key management persons to subscribe to the offer, identity of allottees, whether promoters/directors are subscribing, pre-issue and post preferential issue shareholding pattern,
- ii. The details of all monies utilized out of the preferential issue proceeds have to be disclosed under an appropriate head in the balance sheet of the company indicating the purpose for which such monies have been utilized. Also the details of unutilized monies shall be disclosed under a separate head in the balance sheet of the company indicating the form in which such unutilized monies have been invested.

#### **B. PRICING**

- iii. Minimum price at which the preferential allotment of shares can be made has been spelt out. The price has to be at least the higher of average of the weekly high and low of the closing prices of the shares quoted on the stock exchange

during the 6 months or two weeks preceding the relevant date, which is thirty days prior to the date of shareholders meeting called for the purpose of consideration of the preferential allotment.

#### **C. RESTRICTION ON PRIOR SALE BY ALLOTTEES**

iv. Shareholders of the company who have sold its shares during the six month period prior to relevant date shall not be eligible for allotment of shares on preferential basis.

#### **D. UPFRONT PAYMENT**

v. The shares allotted through preferential allotment have to be fully paid up at the time of allotment.

vi. In case of issue of warrants which can be converted later into shares, a minimum upfront amount of twenty five per cent of the exercise price of warrants has to be paid to the company at time of issue of warrants and this sum shall be forfeited by the company if the allottee do not exercise / convert the warrants on the later date.

#### **E. TENOR OF CONVERTIBLES ISSUED ON PREFERENTIAL BASIS**

vii. Convertible instruments, including warrants, issued through preferential allotment shall only have a currency of eighteen months.

## **F. OTHER REQUIREMENTS**

- viii. Allotment of shares/ securities through preferential allotment has to be completed within fifteen days of obtaining shareholders approval.
- ix. Company has to make preferential allotment only if it has obtained the PAN of the proposed allottees.
- x. A listed company shall not make any preferential issue if the company is not in compliance with the conditions of continuous listing.
- xi. In case of every issue of financial instruments having conversion option, the statutory auditors of the issuer company shall certify that the issue of the said instrument is being made in accordance with the requirements of the Guidelines.

## **G. LOCK IN**

- xii. Entire pre preferential allotment shareholding of the allottee to be under lock-in for 6 months from the relevant date.
- xiii. Shares allotted have to be locked-in for a minimum one year or three years as the case may be.
- xiv. In case of issue of warrants, the same shall be locked in for the entire tenor of the warrants. In addition, shares resulting on conversion of warrants have to be locked in for a period of one year or three years as the case may be from the date of allotment of shares.

While the above conditions are applicable for all preferential issue made by all listed companies, irrespective of the nature of allottee i.e whether promoters or non promoters, there are certain additional conditions in case of preferential allotment to the promoters of the company. These are detailed as under:

xv. Shares issued to promoters have to be locked in for a minimum period of three years from the date of allotment as against one year for other allottees.

xvi. If preferential allotment is for consideration other than cash, valuation of the assets in consideration for which the shares are proposed to be issued shall be done by an independent, qualified valuer and the valuation report shall be submitted to the exchanges on which shares of the issuer company are listed.

xvii. The preferential allotment shall not result in reducing the minimum public shareholding requirement.

7. Thus, it is clear that the Guidelines with respect to the 'preferential allotment' does not distinguish between preferential allotment to 'promoters' and 'non promoters' and the same is applicable irrespective of the identity of the allottee. However, for preferential allotment to promoters, there are additional checks and balances. In the absence of such provisions in the Guidelines, the promoters would be having unhindered freedom to make preferential allotment of shares or warrants at any price or quantity once a resolution under Section 81 (1A) of the Act is passed. SEBI has been reviewing the Guidelines pertaining to preferential allotment on an on-going basis in consultation with its advisory

committees and necessary amendments are made wherever found necessary to strengthen the Guidelines and to retain their efficacy in a constantly evolving and a dynamic market. The amendments made over the years since the guidelines were first notified in 1994 are given here under including some important amendments/changes to the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter referred to as Takeover Regulations).

Sr. No.	Earlier provision /Clause	Amendment	Amendment date
1.	Nil	<u>Lock-in Clause Inserted</u> In addition to the requirements for lock in of instruments allotted on preferential basis to promoters/ promoter group as per Clause 13.3.1 the instruments allotted on preferential basis to any persons including promoters/ promoter group shall be locked-in for a period of one year from the date of their allotment.	August 4, 2000
2.	Nil	<u>Disclosure Clause Inserted:</u> The explanatory statement to the notice for the general meeting in terms of Section 173 of the Companies Act, 1956 shall contain: <ol style="list-style-type: none"> <li data-bbox="683 1220 1214 1283">i. the object/s of the issue through preferential offer,</li> <li data-bbox="683 1283 1214 1377">ii. intention of promoters/ directors/ key management persons to subscribe to the offer,</li> <li data-bbox="683 1377 1214 1451">iii. shareholding pattern before and after the offer,</li> <li data-bbox="683 1451 1214 1514">iv. proposed time within which the allotment shall be complete</li> <li data-bbox="683 1514 1214 1608">v. the identity of the proposed allottees and the percentage of post preferential issue capital that may be held by them.</li> </ol>	Aug 04, 2000
3.	Nil	<u>Disclosure Clause Inserted:</u> The details of all monies utilized out of the preferential issue proceeds shall be disclosed under an appropriate head in the balance sheet of the company indicating the purpose for which such monies have been utilized. The details of unutilized monies shall also be	Aug 04, 2000

Sr. No.	Earlier provision /Clause	Amendment	Amendment date
		disclosed under a separate head in the balance sheet of the company indicating the form in which such unutilized monies have been invested.	
4.		<u>Up-front payment Clause Inserted</u> <u>The equity shares and securities convertible into equity shares at a later date, allotted in terms of the above said resolution shall be made fully paid up at the time of their allotment.</u>	
5.		<u>Restriction Clause for Preferential Issue Inserted:</u> A listed company shall not make any preferential issue of equity shares, Fully Convertible Debentures, Partly Convertible Debentures or any other instrument which may be converted into or exchanged with equity shares at a latter date if the same is not in compliance with the conditions for continuous listing.	Aug 14, 2003
6.		<u>Restriction on currency of shareholder resolution Inserted:</u> If allotment of instruments and dispatch of certificates is not completed within 3 months from the date of such resolution, a fresh consent of the shareholders shall be obtained and the relevant date referred to in explanation (a) in paragraph 13.1.1.1 above will relate to the new resolution.	Aug 04, 2000
7.	<i>If allotment of instruments and dispatch of certificates is not completed within <b>3 months</b> from the date of such resolution, a fresh consent of the shareholders shall be obtained and the relevant date referred to in explanation (a) in paragraph 13.1.1.1 above will relate to the new resolution.)</i>	<u>Substituted by further Restriction on Currency of Shareholders Resolution</u>  The words 3 months with <b>fifteen days</b>	Jan 25, 2005
8.	Nil	<u>Inserted:</u> An issue of shares on preferential basis to Qualified Institutional Buyers not exceeding five in numbers all be made at a price not less than the average of the weekly high and low	Aug 28, 2008

Sr. No.	Earlier provision /Clause	Amendment	Amendment date
		of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date	
9.		<u>Clause on valuation of Consideration by Independent valuer Inserted:</u> In case of preferential allotment of shares to promoters, their relatives, associates and related entities, for consideration other than cash, valuation of the assets in consideration for which the shares are proposed to be issued shall be done by an independent qualified valuer and the valuation report shall be submitted to the exchanges on which shares of the issuer company are listed.	Aug 14, 2003
10.	<i>The issue of shares on a preferential basis can be made at a price not less than the higher of the following</i>	<u>Pricing brought closer to the market price. Substituted by</u> Where the equity shares of a company have been listed on a stock exchange for a period of six months or more as on the relevant date, the issue of shares on preferential basis other than an issue of shares on preferential basis to Qualified Institutional Buyers not exceeding five in number, shall be made at a price not less than higher of the following	April 30, 2007 Aug 28, 2008
11.		<u>PAN Clause Inserted:</u> A listed company shall not make any preferential allotment of equity shares, FCDs, PCDs or any other financial instrument which may be converted into or exchanged with equity shares at a later date unless it has obtained the Permanent Account Number of the proposed allottees.	Nov 29, 2007
12.	<i>“Where the equity shares of a company have been listed on a stock exchange for a period of less than six months as on the relevant date, the issue of shares on preferential basis can be made at a price not less than the higher of the following”</i>	<u>Inserted</u>  other than an issue of shares on preferential basis to Qualified Institutional Buyers not exceeding five in Number	Aug 28, 2008
13.	An amount equivalent to at least ten percent of the price fixed in terms of Clause 13.1.1.1	<u>Up front payment of warrants raised to 25% Clause Substituted:</u>  The words ten percent was substituted by	Feb 24, 2009

Sr. No.	Earlier provision /Clause	Amendment	Amendment date
	above shall become payable for the warrants on the date of their allotment	twenty five percent	
14.		<u>Inserted:</u> Clauses 13.1 and 13.3 shall not be applicable to shares allotted to any financial institution within the meaning of sub-clauses (ia) and (ii) of clause (h) of section 2 of the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (51 of 1993)	Apr 30, 2007
15.	<i>Nil</i>	<u>Inserted:</u> Clause 13.1.1, 13.1.2, 13.1.3, 13.1A, and 13.5.1 shall not be applicable to a preferential allotment of equity shares, fully convertible debenture and partly convertible debentures, where the Board has granted relaxation to the company in terms of Regulation 29A of the Takeover Regulations. Provided that adequate disclosures about the plan including the process proposed to be followed for identifying the allottees, are given in the explanatory statement to notice for the general meeting of shareholders, in addition to disclosures required in terms of any other law.	Feb 24, 2009
16.	“In addition to the requirements for lock in of instruments allotted on preferential basis to promoters/ promoter group and the shares allotted to such promoter / promoter group pursuant to exercise of options attached to warrants issued on preferential basis as per clause 13.3.1 (a) and (b), the instruments allotted on preferential basis to any person including promoters/ promoters group shall be locked-in for a period of one year from	<u>Substituted</u>  The instruments allotted on preferential basis and the shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to the promoter / promoter group of the issuer, in addition to the instruments or shares specified in sub-clauses (a) and (b) of clause 13.3.1, shall be locked-in for a period of one year from the date of their allotment.	Feb 24, 2009

Sr. No.	Earlier provision /Clause	Amendment	Amendment date
	the date of their allotment		
17.		<u>Inserted:</u> The instruments allotted on preferential basis and the shares allotted pursuant to exercise of options attached to warrants issued on preferential basis to any person other than the promoter / promoter group of the issuer shall be locked-in for a period of one year from the date of their allotment	Feb 24, 2009
18.	The lock-in on shares acquired by conversion of the convertible instrument 526(other than warrants) 527(Deleted), shall be reduced to the extent the convertible instrument have already been locked-	<u>Inserted:</u> “Other than warrants”	Feb 24, 2009
<p>19. In addition to the above amendments, SEBI had also amended Regulation 3 (1) of the Takeover Regulations by omitting clause (c) from the said regulation which provided that Regulations 10, 11 and 12 of the Takeover Regulations shall not apply to preferential allotment made in pursuance of a resolution passed under Section 81(1A) of the Act. As a result, preferential allotments which resulted in the allottees acquiring more than 5% of voting rights had to necessarily seek an exemption from the ‘public announcement’ requirement in terms of Regulation 4 of the Takeover Regulations).</p>			

8. I also note that for a preferential allotments of warrants or shares, the company has to get a special resolution (in accordance with the provisions of Sections 81(1A) & 189 of the Companies Act, 1956 and the relevant provisions of the Guidelines) passed in the general body meeting of its shareholders wherein 75% of those shareholders present and voting have to vote in favour of the resolution. Further, the explanatory statement to the notice for the general meeting in terms of Section 173 of the Companies Act, 1956 should contain the following:

- i. the object/s of the issue through preferential offer,

- ii. intention of promoters/ directors/ key management persons to subscribe to the offer,
- iii. shareholding pattern before and after the offer,
- iv. proposed time within which the allotment shall be complete
- v. the identity of the proposed allottees and the percentage of post preferential issue capital that may be held by them.

9. Considering the disclosure of details like, objects of issue, names of allottees, whether promoters/directors are subscribing etc. to the shareholders in the notice to general body meeting, the shareholders have an opportunity to vote against the resolution if they find it detrimental to their interest. Further, in case of any oppression by majority and mismanagement of the company, the Act, under Sections 397 to 399, provides relief to the minority shareholders by providing for filing complaints before the Company Law Board, alleging such oppression and mismanagement.

10. I further note that warrants are generally issued by companies in cases where fund requirement is anticipated in future. In such cases, the company issuing warrants collects an upfront amount. The collection of the 'upfront amount' ensures that the allottees of such warrants are persuaded to exercise those warrants, since, in case of non-exercise, they are at the risk of losing the upfront amount. This also ensures that a part of the anticipated fund requirement is already realized irrespective of whether the warrants are exercised at a later date or not, by the allottees. I further note, that in terms of Clause 13.1.2.3 of the Guidelines, an amount equivalent to atleast 'twenty five percent' (substituted vide SEBI Circular No. SEBI/CFD/DIL/DIP/34/2009/24/09 dated February 24, 2009, for the words "ten percent") of the price fixed in terms of Clause 13.1.1.1 (pricing of the issue) shall become payable for the warrants on the date of their allotment. Also, this upfront amount of 25% of the price of

the warrants so issued shall be adjusted against the price payable subsequently for acquiring the shares by exercising an option for the purpose. It would be pertinent to note that the upfront amount shall be forfeited by the company if the option to acquire shares is not exercised by the allottees. I further note that the revision in the upfront amount (25% of the price of the warrants to be issued) had been implemented following the recommendations of the Primary Market Advisory Committee [PMAC] constituted by SEBI, which had discussed the trend of promoters allotting warrants to themselves and not exercising warrants when the price of shares fall significantly down. Capital, whether in the form of 'equity' or 'debt' comes with a cost. For equity, the servicing cost would be the dividends and for debt, the servicing cost would be the interest. Considering the cost involved in raising capital, companies would generally prefer to raise capital only when it is necessary. It would be illogical to expect a company to raise capital today for an uncertain future requirement. Warrants are special financial products designed for those unique needs and have been in use in capital markets the world over. I also note that in other jurisdictions, the option premium is generally in the range of 10% to 15% for trading of long dated options. Warrants being in the nature of long dated options, in India, the 25% upfront payment (calculated on the price of the warrants) payable at the time of allotment of the warrant is undoubtedly a high premium to forego in case the warrant holder fails to exercise the option to convert the warrants into equity shares. On considering the singular nature and purpose of issue of warrants, the same cannot be compared to 'option trading' as alleged by the petitioner.

11. The petitioner has submitted that the promoters, who do not exercise their option on the warrants initially, go for fresh allotment of warrants at lower prices, thereby making unjustified profits and gains of astronomical amounts to the detriment of the company and general body of shareholders. According to the petitioner, the same appeared to be primarily based on the assumption that

consequent to the general election results and the expected stable government, the stock markets and resultantly the price of the company's shares will certainly go up. The same may not be correct. The price of a company's share is dependent on a multitude of factors including demand and supply for the shares, industry performance, political developments, international events, global economic conditions, etc. Therefore, the possibility of share prices falling much below the exercise price of freshly issued warrants cannot be excluded. Non-exercise of warrants by an allottee of a warrant should be viewed more as a missed fund raising opportunity rather than a possible loss to the company or its shareholders. As said earlier, the company forfeits the 'upfront amount' when the promoter/allottee does not exercise his option of converting the warrant into shares. The upfront amount which is surrendered by the warrant allottee is retained by the company, with no further obligations attached to it. It is again reiterated here that with the increase in the upfront amount (of 25% of the price fixed in terms of Clause 13.1.1.1 of the Guidelines that becomes payable for the warrants on the date of their allotment), the chances of non-exercise of warrants are reduced.

12. The petitioner had submitted that the directors of the companies have not discharged their fiduciary obligations to the shareholders and the company and that they had acted only for the interest of the promoters. It had further submitted the independent directors were very well aware of the direction the stock market would take and that should have insisted that any fresh fund raising should only be done by way of Rights Issue, which would benefit all the shareholders of the company. In this regard, I note that voting rights of shareholders are governed by Section 87 of the Act. It may be seen that Section 55A of the Act does not empower SEBI to administer this provision of the Act. However, regarding restrictions on voting rights, there appears to be

two divergent views - one which believes that such restrictions are not permissible/sustainable under the provisions of the Act, and another, which believes that reasonable restrictions can be imposed without compromising the inherent voting rights of the promoters in their shareholding in the company. With respect to the role of directors, Clause 49 of listing agreement on corporate governance has not specifically dealt into the role and the responsibilities of the independent directors in depth, mainly because the provisions of the Companies Act already casts a fiduciary duty on all the directors including independent directors towards the shareholders.

13. I also note that SEBI had obtained clarification from the 8 companies which were mentioned in the representation of the petitioner. It is noted that in all the 8 companies, the company had forfeited the upfront amount when the promoters did not exercise the warrants. The forfeited amount ranges from Rs.783 crores in case of Reliance Infrastructure Limited and Rs.377 crores in case of Aditya Birla Nuvo Limited to Rs.6.52 crore in case of Nagarjuna Fertilizers Limited. The said 8 companies together forfeited Rs.1515 crores when the promoters failed to exercise their warrants and the forfeited sum was retained by the respective companies. Considering that the said forfeited amount is without any liability, it may be incorrect to argue that the promoters stand to gain at the cost of the company and its shareholders. Also, few companies which had cancelled the warrants have clarified that the same was done following intimation from allottees that they would not be exercising those warrants. A warrant holder is never obliged to exercise the warrant and hence the question of default does not arise. Warrant is not a debt security and the concept of defaulting on warrant itself is erroneous. Further, from the data obtained by SEBI from Bombay Stock Exchange Limited and National Stock Exchange of India Limited in respect of preferential allotments made by various companies during the period between April 2007 and June 2009, it is noted that

only 13 companies had re-issued warrants to promoters following non-exercise of earlier warrants. It is also noted that of the 4934 listed companies, there had been 1108 preferential allotments since April 2007, of which only 360 were preferential allotment of warrants. Out of the said 360 cases, there were only 100 companies where promoters did not fully exercise the option on the warrants issued to them. Considering the total number of listed companies and number of preferential allotments made during the above period, it is seen that the instances of reissue of warrants to the promoters have not been significant or frequent. Further, the amendment to the Guidelines on February 24, 2009 effecting an increase in the minimum upfront amount to be paid to the company at time of issue of warrants from 10% to 25% of the exercise price of warrants would act as a deterrent for fresh issuance of warrants subsequent to non-exercise of previous warrants.

14. In view of the foregoing, I observe that:
  - a. Mere non-exercise of warrants by promoters or consequent fresh issuance of warrants to promoters does not appear to be in violation of the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000.
  - b. With regard to the request for amending the Securities and Exchange Board of India (Disclosure and Investor Protection) Guidelines, 2000 to the effect that promoters can be allotted shares or convertible instruments on preferential basis only on the payment of full amount towards the issue; the same would discourage the companies to raise funds through the allotment of warrants and also indirectly restrict the issue of capital to only shares of the company. Considering the nature of the said instruments (warrants) and the fact that only few instances (as

brought out in Para 10 above) were noticed where the warrants issued to the promoters had not been exercised, it would be a retrograde step to disable a product which is accepted universally as a fund raising tool. Such a restriction on issuance of warrants may also deprive the operational and capital structuring flexibility for Indian companies.

- c. With respect to the request of the petitioner to strictly prohibit further preferential issue to such persons who have defaulted in their commitments to the company for taking allotment of shares against warrants allotted to them earlier, it is noted that subscription to warrants does not cast any obligation on the warrant holder to subscribe to the company's shares at a later date. The warrant holders have a right to either convert the warrants into shares or not to do so. Therefore, the view of the petitioner that such 'warrant holders have defaulted in their commitment to the company by not exercising the warrants and therefore further issuance of warrants to such persons should be prohibited', would not be maintainable as a warrant holder who has decided not to exercise his right to convert, can not be termed as "defaulter". Further, allotment of warrants to a person whether promoter or non promoter, is a decision taken by the shareholders of the company. However, the Securities and Exchange Board of India would take note of the concerns expressed and would initiate a consultative process including taking views of market participants and various other stakeholders, to suggest policy changes, if required, to address the said concern.
- d. Similarly, in respect of the petitioner's request that Securities and Exchange Board of India should immediately issue regulations prohibiting the promoters from voting in the general meeting on any resolution in which they are interested in, the Securities and Exchange

Board of India would take note of the same and initiate a consultative process including taking views of market participants and various others stakeholders, to suggest policy changes, if required, to address the said concern.

15. Accordingly, the representation dated June 04, 2009 made by M/s. Rajkot Saher/Jilla Grahak Suraksha Mandal is disposed of.

**DR. K. M. ABRAHAM  
WHOLE TIME MEMBER  
SECURITIES AND EXCHANGE BOARD OF INDIA**

**Place: Mumbai  
Date: July 30, 2009**